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ORIGIN EUR-12

INFO OCT-01 ISO-00 CIAE-00 PM-03 INR-07 L-02 ACDA-10

NSAE-00 PA-02 PRS-01 SP-02 USIA-15 TRSE-00 SAJ-01

DODE-00 SS-15 NSC-05 EB-07 COME-00 /083 R

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JS/J-4:CDR LEWIS

OSD/ISA:GEN MCAULIFFE

----- 116317

R 102221Z MAR 75

FM SECSTATE WASHDC

TO USMISSION NATO

INFO USCINCEUR

NAVFACENGCOM ALEX VA

UNCLAS STATE 053541

E.O. 11652: N/A

TAGS: MARR, NATO

SUBJECT: USE OF PRICE VARIATION CLAUSES IN NATO
-- INFRASTRUCTURE CONTRACTS

REF: USNATO 0975

THE FOLLOWING RESPONDS TO INQUIRIES IN REFTEL REGARDING
US POLICY AND REGULATIONS IN USE OF PRICE VARIATION
CLAUSES.

1. CURRENT DOD POLICY IS AGAINST THE USE OF SUCH PRICE
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ADJUSTMENT CLAUSES IN US MILITARY CONSTRUCTION CONTRACTS.

TO ASSURE THAT PROJECTS CAN BE COMPLETED WITHIN AUTHORIZED AMOUNTS, THE US SERVICES DEVELOP THE MOST REALISTIC POSSIBLE PROJECT COST ESTIMATES PROJECTED TO THE ESTIMATED TIME OF ACTUAL CONSTRUCTION. TO ALLOW FOR INFLATION, ANTICIPATED MATERIAL AND LABOR COST ESCALATION ARE FACTORED INTO THE FINAL ESTIMATES SUBMITTED TO THE CONGRESS. AS YOU ARE AWARE, CONGRESSIONAL MILCON AUTHORIZATION APPROVALS ARE GIVEN ON A LINE ITEM BASIS BY INSTALLATION, BASED ON SPECIFIC DOLLAR COST ESTIMATES FOR EACH PROJECT, AGAINST A CLEARLY DEFINED SCOPE. WHILE SOME PROJECT COST VARIATION IS PERMITTED, UPPER COST LIMITS ARE ESTABLISHED UNDER THE AUTHORIZATION LAWS AND MAY NOT BE EXCEEDED, CONTRACTUALLY OR OTHERWISE, WITHOUT AMENDED LEGISLATION.

CONSTRUCTION COST ESTIMATES CONTAINED IN THE DOD FIVE YEAR DEFENSE PROGRAM ARE REGULARLY ADJUSTED TO REFLECT ECONOMIC TRENDS AND ANTICIPATED ACTUAL COSTS FOR THE FUTURE YEAR PROGRAMS.

2. THE US MILITARY DEPARTMENTS HAVE BEEN REVIEWING THE SUBJECT OF PRICE ADJUSTMENT CLAUSES FOR POSSIBLE USE IN FIXED PRICE FORMALLY ADVERTISED CONSTRUCTION CONTRACTS. A CLAUSE COVERING CERTAIN LIMITED CONSTRUCTION MATERIALS HAS BEEN DEVELOPED BY THE ARMY CORPS OF ENGINEERS FOR USE ONLY IF INFLATIONARY TRENDS IN CONSTRUCTION COSTS SHOULD BECOME SO UNCONTROLLED AS TO THREATEN THE FEASIBILITY OF RECEIVING GOOD BIDDING COMPETITION ON FIXED PRICE CONTRACTS. IT HAS NOT BEEN IMPLEMENTED FOR USE

AND THERE ARE NO CURRENT PLANS TO USE IT. IN NO CASE, HOWEVER, COULD THE COST LIMITATIONS ESTABLISHED IN THE ANNUAL MILITARY CONSTRUCTION AUTHORIZATION ACTS BE EXCEEDED.

3. BECAUSE OF COUNTRY-TO-COUNTRY AGREEMENTS, THE CONTRACTING SITUATION IS DIFFERENT FOR CONSTRUCTION IN CERTAIN FOREIGN COUNTRIES. IN ICELAND, WHERE THE U.S. IS HOST FOR INFRASTRUCTURE PROJECTS, CONTRACTS INCLUDE PRICE REVISIONS AND PRICE ESCALATION CLAUSES TO COVER REVALUATION OF ICELAND KRONER AND INCREASES IN LOCAL UNCLASSIFIED

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WAGE RATES. SIMILARLY, IN THE ABSENCE OF EXCLUSION UNDER A CONTRACT, APPLICATION OF ITALIAN LAW REQUIRES A PRICE REVISION CLAUSE FOR CONSTRUCTION UNDERTAKEN IN ITALY IN APPROPRIATE CASES. IN THE CASE OF BERMUDA, WHERE US HAS ALSO ASSUMED HOST NATION RESPONSIBILITIES, THERE IS NO AGREEMENT REQUIRING AN ESCALATION CLAUSE, SO CONTRACT AWARDS ARE ON A FIXED PRICE BASIS.

4. IN RECOGNITION OF THE IMPACT OF ENERGY SHORTAGE ON DOD PROCUREMENT, DOD POLICY HAS CONCENTRATED ON TECHNIQUES FOR AWARDED NEW PROCUREMENT CONTRACTS AND WAYS OF ADMINISTERING THEM TO MITIGATE THE IMPACT OF SHORTAGES AND EXTREME PRICE ESCALATION ON GOVERNMENT CONTRACTORS. FOR ACQUISITION OF MAJOR DEFENSE SYSTEMS, DOD PRIME CONTRACTS FOR HIGH ECONOMIC RISK EFFORTS CHARACTERISTICALLY INCLUDE SOME FORM OF PRICE ADJUSTMENT PROVISIONS FOR ESCALATION. DOD POLICY SUPPORTS THE SAME DEGREE OF PROTECTION FOR SUB-CONTRACTORS.

5. WE BELIEVE A POSITIVE ACTION NATO CAN TAKE AT THIS TIME IS TO IMPROVE THE NATO ESTIMATING AND REPORTING SYSTEM AND TIGHTEN CONTROL OVER CHANGE ORDERS. THREE SPECIFIC SUGGESTIONS WE OFFER FOR CONSIDERATION ARE:

(A) DEVELOP PROCEDURES TO MAINTAIN AND UPDATE PROJECT ESTIMATES FROM DATE OF ORIGINAL SLICE APPROVAL TO ADVERTISING FOR BID SO THAT CURRENTLY VALID ESTIMATED COSTS ARE CONTINUOUSLY REFLECTED;

(B) REQUIRE NATIONS TO REPORT IMMEDIATELY CONTRACT AWARDS (THIS IS BEING DONE NOW) AND REQUIRE AN IMMEDIATE REVISION IN THE CWE AND AUTHORIZED AMOUNT BASED ON THE CONTRACT AWARD AMOUNT PLUS A FIXED PERCENTAGE FOR CONTINGENCY (PERHAPS 2 OR 3 PERCENT);

(C) GENERALLY LIMIT CHANGE ORDER AUTHORIZATIONS TO WITHIN SCOPE CHANGE ORDERS DUE TO UNFORESEEN SITE CONDITIONS, DESIGN OMISSIONS, ETC. OUT OF SCOPE CHANGE ORDERS SHOULD ONLY BE AUTHORIZED BY THE P AND P COMMITTEE.

6. THE FOLLOWING MATERIAL HAS BEEN SENT TO MR. LOVELAND:
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(A) OCE PRICE ADJUSTMENT CLAUSE FOR FIXED-PRICE FORMALLY ADVERTISED CONSTRUCTION PROJECTS (PARA 2 ABOVE);

(B) PRICE ESCALATION CLAUSES APPLICABLE TO ICELAND AND ITALY (PARA 3 ABOVE);

(C) ASD/I AND L POLICY MEMOS OF JUNE 12, 1974 AND NOVEMBER 27, 1974 COVERING IMPACT OF ENERGY SHORTAGE ON DOD PROCUREMENT AND POLICY ON MAJOR DEFENSE SYSTEM B SUBCONTRACTS (PARA 4 ABOVE);

(D) ASPR PROVISIONS ON ECONOMIC PRICE ADJUSTMENT ON PROCUREMENT BY FORMAL ADVERTISING;

(E) ASPR PROVISIONS ON ECONOMIC PRICE ADJUSTMENT ON PROCUREMENT BY NEGOTIATION;

(F) ASPR SAMPLE ECONOMIC PRICE ADJUSTMENT CLAUSES;

(G) COMPLETE ASPR PROVISIONS (SECTION XVIII) COVERING CONSTRUCTION AND ARCHITECT-ENGINEER CONTRACTS. OTHER ASPR PROVISIONS ARE ALSO APPLICABLE TO CONSTRUCTION CONTRACTS, UNLESS CLEARLY INCONSISTENT WITH A PROVISION IN SECTION XVIII, IN WHICH CASE SECTION XVIII PROVISION APPLIES.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MILITARY BASES, CONTRACTS, COMMITTEE MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 10 MAR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975STATE053541
Document Source: CORE
Document Unique ID: 00
Drafter: MR MILLER:DH
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750084-0590
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750365/aaaacgoe.tel
Line Count: 182
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: 75 USNATO 0975
Review Action: RELEASED, APPROVED
Review Authority: ShawDG
Review Comment: n/a
Review Content Flags:
Review Date: 10 JUN 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <10 JUN 2003 by BrownAM>; APPROVED <26 FEB 2004 by ShawDG>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: USE OF PRICE VARIATION CLAUSES IN NATO -- INFRASTRUCTURE CONTRACTS
TAGS: MARR, NATO
To: NATO BRUSSELS
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006